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SUBJECT: WEATHERING THE STORM: COLOMBIA'S EXPOSURE TO THE
GLOBAL MARKET TURMOIL

REF: BOGOTA 3076

¶1. (SBU) SUMMARY. Amid ongoing turmoil in U.S. and global financial markets, Colombia's financial sector appears at low susceptibility to a contagion and its macro-economic foundation significantly more stable than during the 1998 international financial crisis. Nevertheless, local experts predict that Colombia's already slowing growth rate could downshift further as demand for Colombia exports, investment inflows, and sources of international financing dry up. Consequent reductions in GOC tax revenues may also force a round fiscal tightening even while the GOC struggles to fund its social and security priorities. Finally, fewer foreign capital inflows are likely to curb the peso's appreciation, helping competitiveness of long-suffering Colombian exporters, but risking an uptick in inflation. END SUMMARY.

The Strengths

¶2. (SBU) Despite nervousness regarding recent global economic events, Colombian officials and private sector experts agree that Colombia's exposure is limited and the economy remains well-positioned to ride out the crisis. According to the Office of the Financial Superintendent, the Colombian banking sector's direct exposure to the international sub-prime market is minimal. Of the financial sector's USD 15.6 billion in assets, only USD 36 million is invested in international banking institutions. Likewise, Colombia's pension funds have limited investment exposure in the U.S. sub-prime mortgage market. According to the Superintendent, only one-third of one percent of combined pension fund assets are in structured investment vehicles. Nevertheless, Colombian bankers recognize that they cannot completely escape the pressure on global financial industry, pointing out that the American Depository Receipts (ADRs) of Colombia's largest bank, Bancolombia, have lost almost 12 percent of their value in New York trading since the beginning of the year.

¶3. (SBU) Beyond asset exposure, experts insist that Colombia's financial sector and economy are on a much more solid footing than during the last economic crisis of the late 1990s. National Association of Financial Institutions (ANIF) President Sergio Clavijo cited to us Colombia's record high international reserves (USD 24 billion), lower public and private debt levels (as a percentage of GDP), lower current and fiscal account deficits (as a percentage of GDP) and the local financial sector's strong profitability as key insulators from the crisis. Juan Pablo Cordoba, President of

the Colombian Stock Exchange (BVC), echoed the sentiment that Colombia's exposure is limited, even while the BVC market index (IGBC) remains down 14 percent for the year.

The Weaknesses

¶4. (SBU) Clavijo, Cordoba and other analysts, such as the brokerage firm Correval, acknowledge that reduced global growth in 2008 will translate into sluggish Colombian growth in the medium term as demand for raw material exports such as oil, nickel, and coal, falls. In particular, a slower U.S. economy, which represents Colombia's largest export market (36 percent of total exports in 2007) and source of foreign direct investment (21 percent of total inflows in 2007), will hurt Colombian export industries. Likewise, if oil prices fall as a result of reduced global demand, the purchasing power of Colombia's second most important trading partner, Venezuela (14 percent of Colombian exports in 2007), could drop in correlation and exacerbate the pressure on Colombian exporters.

¶5. (SBU) On the fiscal and debt service side, lower raw material prices would also trim Colombia's revenues from state-owned hydrocarbons company Ecopetrol and the royalties that international mining and hydrocarbons firms pay the GOC. Any reduction in resource revenues would generate pressure on the GOC to implement commensurate cuts in government expenditures in order to stay within GOC fiscal targets. Meanwhile, the international financial market turbulence could raise Colombia's cost to finance public and private

debt on world markets.

End of the Good Times?

¶6. (SBU) Concern has spread that the Colombian economy is entering a prolonged period of slower growth. After averaging over five percent annual GDP growth since 2002 and reaching eight percent in 2007, the GOC reported that growth in the first half of 2008 totaled only 4.1 percent. Taken together with the international market turmoil, several local financial institutions and analysts subsequently lowered 2008 growth estimates from five percent to as low as 3.8 percent, and 2009 projections to below five percent. ANIF President Clavijo told us he estimates the overall economy will grow 3.7 percent in 2008 (down from ANIF's estimate of 4.7 percent three months ago) and only 3.5 percent in 2009 (down from the previous ANIF estimate of 4.3 percent). Nevertheless, Clavijo downplayed concerns of a Colombian recession and said he considers this a "natural, soft landing" for the economy after its rapid clip in 2006-07.

¶7. (SBU) Central Bank President Jose Dario Uribe and Finance Minister Oscar Ivan Zuluaga have publicly acknowledged that the international financial crisis could bleed growth from the Colombian economy, but emphasize that Colombia remains well-positioned to weather the storm. Zuluaga added that the GOC must reinforce its position by adjusting public expenditures in the 2009 budget, which was calculated based on an expected GDP growth rate of 5 percent. The Ministry estimates that every one percentage point reduction in annual GDP costs the government USD 300 million in lost tax revenue. Such a reduction in spending will significantly complicate GOC efforts to fulfill its poverty reduction and democratic security priorities.

One Silver Lining?

¶8. (U) On the bright side, several Colombian economists have said that due to a slower U.S. and global economy they expect fewer U.S. dollars and other foreign currency to enter the Colombian economy, thereby reducing appreciation pressure on the Colombian peso. The rise of the peso against foreign currencies, especially the U.S. dollar, since the beginning of 2007 significantly eroded the price competitiveness of

many non-mineral Colombian exports such as textiles, cut flowers, and bananas (reftel). After appreciating 28 percent against the U.S. dollar between January 2007 and June 2008, the peso has now devalued 19 percent in the past three months. Our contacts attribute this shift to the combination of overall developing country jitters in currency markets with the consensus that the peso's rise was excessive. They caution, however, that a weaker peso would augment inflationary pressures. Estimates for 2008 inflation currently stand at 7.5-8 percent, double that of beginning of year targets.
NICHOLS